THE PROBLEM OF THE TRUSTS.

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(*Read April 2, 1903.*)

The "Trusts" in the popular, though not in the technical acceptation of the term, are the trading corporations, and combinations of such corporations, which control the production or the sale of one or more natural or manufactured products. "Trusts" thus defined do not include banks, nor other merely financial institutions, nor those "Public Service Corporations" which exercise the power of eminent domain, or which occupy public highways for their own purposes, as by laying rails, pipes or conduits.

The "Trusts" are the necessary result of an industrial evolution, whose successive stages have been individual ownership, partnerships, limited partnerships, corporations and combinations of corporations. Partnerships supersede individual ownership because of the advantages of the combination of the capital or services of two or more individuals. Limited partnerships are organized to facilitate the borrowing of capital by giving to the lender a compensation for the use of his money exceeding the current market rate of interest, while limiting his liability to creditors to the amount of the capital loaned. The same advantages of co-operation with limitation of liability, and with added exemption from adverse and discriminating regulation in other States, can be secured by association under "the Boston Trust Device."[1] Corporations are organized to assure continuity of administration; to obtain by the issue of shares, and sometimes bonds, the use of capital contributed by a larger number of persons than can conveniently be brought together as partners; to secure to shareholders exemption from the individual liability *in solido* of partners; and to render the shares negotiable *inter vivos*, and transferable, after the death of the owner, to personal representatives, or legatees, without the intervention of a court of equity in the settlement of partnership accounts.

In recent years the country has enjoyed a degree of material prosperity which has far exceeded the most hopeful anticipations.

[1] *The Financial Chronicle*, Vol. 75, p. 314, article by Richard W. Hale, Esq.

This has come as a result of the growth of legitimate trade, and several causes have been contributing factors of that growth. The demand for labor; our wide expanse of territory; our isolation from the struggle for the balance of power and the wars of Europe; our comparatively light burdens of taxation; and our free institutions, protecting the citizen against arbitrary power and affording full opportunity for the development of individuality, have attracted immigration and furnished recruits to the army of labor. The policy of protection, whose justification is the equalization of the conditions of competition in order that the products of home industry may control the home market, has stimulated manufactures by increasing the profits of manufacturers, has secured higher wages for workingmen than laborers in similar industries receive in other countries, has enabled our workingmen to maintain a higher standard of living, thereby made them more useful citizens, and enabled them in many instances to rise from the ranks of the employés and to become employers. The railways have overcome the disintegrating influences of distance and of conflicting sectional interests. The establishment of the gold standard has given assurance to the world that capital can be invested in our obligations in confidence of a return in money of full purchasing power, and has commanded for the industrial development of the country the surplus capital of the world.

The business of the United States cannot be done to-day by the agencies of the past. The flatboat floating down the stream; the Conestoga wagon floundering through the mud of a country road; the canal-boat dragged by the mules upon the towing path; the small engine, of weak power and low velocity, drawing a few cars of ten or twenty tons' capacity upon a single-track line and the sailing vessel of small tonnage have all had their day. The typical agencies of modern transportation are the four or six track line, the hundred-ton steel freight car, the engine drawing its passenger train at a rate of sixty miles an hour, the electric lines expanding for every city its tributary territory, and the steamship of more than ten thousand tons' capacity.

Discoveries in science and inventions in the arts have created new subjects of commerce, and have made the luxuries of yesterday the necessities of to-day. Great mills now manufacture the goods which formerly were made in individual workshops. Daily and hourly mails, the telegraph and the telephone have brought widely

separated mines and factories within the limits of combined control. Machinery has increased the rapidity, while diminishing the cost, of manufacture and enlarged the possibility of output. In retail trade department stores have absorbed small shops. It is therefore not surprising that industrial organizations should have been, and should be, formed in number and upon a scale larger than ever before to compete, not only for the trade of their own cities and States, but also for the trade of the country, and in many instances for the trade of foreign countries.

Competition in manufacture and trading, when uncontrolled, is wasteful. It results in reducing the selling price of goods below the minimum necessary to give the producer a fair profit; in overproduction in excess of the market demand; in an increase of disbursements unconnected with production or distribution, and connected only with the conduct of competition; in unnecessary cost of transportation of the raw material to distant points of manufacture, when that raw material could be more economically manufactured nearer to its point of supply; and in the unnecessary cost of the transportation of manufactured products to distant markets, when those markets could be more economically supplied from nearer points of manufacture.[1] Uncontrolled competition also results, in the case of weaker competitors, in lowering the standard of production and in placing upon the market inferior grades of goods.

To meet these results of uncontrolled competition, there came into existence pools or agreements between competitors to secure the maintenance of prices by restrictions upon output, or by limitations of sales. Such agreements are clearly contracts in restraint of trade, and as such non-enforceable in law,[2] and being without legal sanction were, like treaties between sovereign states, broken when either party fancied that its interests would be subserved by their abrogation. Intelligent business men then saw that the expanding trade of the country could not be conducted upon lines which, to quote the words of Mr. Schawb,[3] are built upon "the restriction of trade, the increase of prices and the throttling of competition."

They saw also that in manufacture the maximum of efficiency at

[1] *The Trust Problem*, Prof. J. W. Jenks, 1902.

[2] M. R. C. Co. *v.* B. C. Co., 68 Penna. 173; Cummings *v.* U. B. S. Co., 164 New York, 401; Cohen *v.* B. & J. E. Co., 166 N. Y. 292.

[3] Speech to The Bankers' Club, Chicago, 21st December, 1901.

the minimum of cost can only be accomplished by securing a constant supply of raw material, by making promptly every alteration and improvement in plant and machinery which can effect greater economy in operation, by offering inducements to managers of superior administrative ability, by giving steady employment to workingmen at just wages, by accumulating a reserve fund available for extraordinary expenditures, by increasing the output so as to decrease the cost of production per unit, by expanding trade by creating new avenues for it, and by reducing the price to the consumer, while increasing the profit to the producer. To attain these cost-saving and profit-producing results, combinations of corporations and of properties have been and are being effected, in some cases by the merger and consolidation of existing corporations, and in other cases by the organization of new corporations, to hold and acquire the properties to be consolidated, or to obtain a controlling interest in the shares of the corporations to be combined.

For this there is needed the command of more capital than can be contributed by any one individual or by any group of individuals. Clear-sighted men saw that the prosperity of the country had not only made great fortunes for a comparatively small number of individuals, but had also aggregated in the deposits in the saving funds, in the accumulated reserves of the life insurance companies, and in the deposits in the banks and trust companies a fund of enormous and steadily increasing size, which must necessarily seek profitable investment, and which could be relied upon to make a market for the bonds and shares of corporations with a reasonably probable earning capacity, either by direct investment in those securities or by loaning funds for investment therein; and the appeal was successfully made to these new reserves of loanable funds. Therefore, to-day the capital which is operating the railroads, mining the ore and running the mills of the country is not provided by the rich men of the country, but is the accumulation of the savings of labor.

The test of the investment value of an industrial security is its reasonable probability of a continued earning capacity adequate to the payment of fixed charges and dividends at a rate exceeding that yielded by securities of a higher grade; and that probability of continued earning capacity will be affected by the relation between the cost and the real value of the properties bought for combination by the moderation or extravagance of the compensation given to

the promoters and underwriters, by the soundness of the principles upon which the combination is organized and conducted, and by the freedom of the business from governmental interference. It is not surprising that the number of the industrial organizations and the magnitude of their operations should arouse the public interest and should cause more or less fear as to possible consequences. Every great industrial development has excited such fears. The steam engine, the railways and all forms of labor-saving appliances, from the spinning jenny to the typesetting machine, have seemed n their turn to threaten large additions to the ranks of the unem ployed and heavy losses to different classes of people; and yet, in each case, the result has been the opening of new avenues to employment and a substantial advance in civilization. So to-day no one who is accurately informed as to present industrial conditions can doubt that, because of American financial skill in securing combination of resources and concert of action, the products of industry have been brought to a higher standard, the labor which produces them is better paid than ever before, and the consumer buys them upon relatively more favorable terms.

Concurrently with the organization of corporations with increased capital for production, manufacture and trade, there have come into operation unions of laborers of larger membership and greater activity. Every one ought to concede that it is right that workingmen should receive full and adequate compensation for their labor and should have that legally guarded freedom of contract which will enable them to sell their labor to the best advantage. Every one ought to concede also that workingmen should form associations for the protection of their interests and to secure increases in their wages; but it is not right that those union-should undertake to reduce the mass of workingmen to a low level of mediocrity by means of limitations of the hours of voluntary labor, and by restrictions upon the quantity and quality of work to be performed by the individual laborer; nor is it right that the unions should attempt to monopolize the supply of labor by preventing the employment of non-union laborers. Such limitations and restrictions aggrandize the labor leaders, but they degrade the workingmen; they tend to deprive intelligent, industrious and ambitious workingmen of the opportunity to rise out of the ranks; they diminish that effectiveness of American labor which has been not the least of the causes of the country's industrial supremacy; and

they endanger the continuance of our present prosperity. Combinations of laborers for such purposes are monopolies in restraint of trade.[1] The law should clearly recognize the right of association, but it should also require the incorporation and registration of labor unions in order that there may be legal responsibility for broken contracts; it should, in cases of strikes, impartially enforce law and maintain order, and it should sternly repress any attempt, by whomsoever made and howsoever made, to hinder men in the exercise of their right to work. We find nothing in party platforms, and we hear nothing from executive officers, legislators or candidates for office as to the need of legislative or executive action to curb the power of the labor leaders or to restrain the excesses of their misguided followers. But we hear much of the need of executive and legislative control and regulation of industrial corporations.

It is said, and it is doubtless true, that some industrial organizations are over-capitalized. In considering the capitalization of a corporation, it must be remembered that whatever be the par of a share of stock, that par is not, like the par of a bond, a principal obligation, to be discharged in a certain number of dollars, but it is only the right to an *aliquot* proportion of the net assets of the corporation, and it really represents an amount in dollars, more or less than its par, in proportion as those assets when liquidated shall realize more or less than the aggregate capital of the corporation. The market price expresses the investors' valuation of that representation as affected by the demand for and supply of the particular stock.

The authorized capitalization of a corporation is, in general, determined by the probable cost of the plant, with the addition of the amount of working capital in money necessary for the successful conduct of the business to be transacted, and sometimes with the further addition of a capitalization of the estimated earning capacity of the plant. Obviously, the issued capital should not, in a properly managed corporation, exceed at any time the actual value of the plant and working capital as determined by present and not prospective earning capacity. In other words, there should be no watered stock.

[1] *In re* Debs, 64 Fed. Rep., 724, 745, 755; 158 U. S., 564; *The Law of Contracts in Restraint of Trade, with Special Reference to Trusts*, by George Stuart Patterson, Esq.

It is asserted by no less eminent an authority than the distinguished lawyer who is now the Attorney General of the United States[1] that the necessary effect of "over-capitalization" is to unduly lower the wages of labor and to unduly increase the prices of the product by imposing upon the managers of the corporation the obligation of paying dividends upon the improper excess of capitalization. This view does not seem to be reasonable, for it would obviously be the effort of the managers at all times to keep down the expenses of operation, to make as many sales as possible, and to realize as large prices as possible, without reference to the interest or dividends to be earned or paid, if for no other reason than that of demonstrating the ability of the managers, and this effort would neither increase nor diminish because of the greater or less size of the capitalization. Indeed the only possible influence of a large capitalization upon the prices of the product of the over-capitalized corporation would be in some cases to cause a lowering of such prices, because of the necessity of making realizing sales.

Complaint is made that competing corporations, in order to destroy competition, discriminate in their prices. But competition is industrial warfare. The seller seeks the highest price that he can obtain; the buyer pays as little as he possibly can. When competition is actively conducted, the seller attains his ends, not only by underselling in order to effect a particular sale, but also by carrying his underselling to the extreme limit of driving his competitors out of business and securing for himself complete control of the market. This is done, as Lord Justice Bowen said,[2] from "the instinct of self-advancement and self-protection, which is the very incentive of all trade." . . . "To say that a man is to trade freely, but that he is to stop short at any act which is designed to attract business to his own shop, would be a strange and impossible counsel of perfection," and to attempt to prohibit it "would probably be as hopeless an endeavor as the experiment of King Canute." You cannot have a real competition which does not compete. Successful commerce buys in the cheapest and sells in the dearest market. Is it proposed that there shall be a general legislative regulation of prices, and if so, what would that amount to?

Among the evils charged against the "Trusts" are an alleged

[1] Speech of Hon. P. C. Knox, Pittsburg, 14 Oct., 1902.

[2] Mogul S. S. Co. *v.* McGregor, 23 Q. B. Div. 598; [1892], C. A. 43.

"insufficient personal responsibility of officers and directors for corporate management." It is enough to say as to this that the laws of some States do, and the laws of all States can, hold corporate managers to a strict responsibility for non-feasance and mal-feasance.

It is also said that these trade organizations have "a tendency to monopoly," but except in the cases of patents and copyrights, and of those who control the sole and exclusive source of supply of a natural product, it is not possible in this day of the world's history to maintain and enforce more than temporarily extortionate prices, for the reason that there is always available a large amount of uninvested capital seeking profitable employment and keenly watching for opportunities of remunerative investment, and therefore intelligent managers of a successful business do not advance prices to a point at which destructive competition will be invited. Prices of commodities are automatically regulated by the law of supply and demand. When, by reason of an apparent permanence of demand and a present inadequacy of the means of supply, prices rise to a level that gives a reasonable assurance of profit to producers, the surplus capital of the world can always be relied upon to augment the means of supply.

It would seem that there is a popular demand for industrial organizations sufficiently strong to overcome repressive legislation. Beginning with the Congressional Anti-Trust law of 2d July, 1890,[1] and the Mississippi statute of the same year,[2] and ending at this time with the sixth section of the United States statute creating the Department of Commerce and Labor, the United States and twenty-nine States and Territories have legislated upon the subject, and two States have deemed it of sufficient importance to place an anti-Trust prohibition in their Constitutions. Some of these State statutes regulate and others of them prohibit, and all of them impose penalties by fine or imprisonment and forfeiture of corporate privileges. Notwithstanding this mass of adverse legislation, industrial corporations have grown and flourished; and yet there is a political clamor for more legislation.

Attempts to regulate trade by legislation are not of new invention. Whenever and wherever there has been an absolute government there have always been attempted restrictions upon trade. In

[1] 26 Stat. 209, c. 467.

[2] c. 36.

mediæval times it was the theory and the practice that it was the "duty and the right of the State to fix hours of labor, rates of wages, prices, times and places of sale and quantities to be sold."[1] The selfish commercial policy of England, intelligently directed to the restraint of colonial trade and manufactures, was the great cause of the War of Independence. When the success of the War of the Revolution had substituted the sovereignty of the people for the supremacy of the Crown, there was naturally a jealousy of governmental power and a determination to guard individual liberty against oppression. The framers of the Constitution of the United States therefore founded the government, not only upon the supremacy of the federal government in the exercise of the powers granted to it, but also and equally upon the independence of the States and the freedom of the citizen. They foresaw the evil effects of an unrestrained exercise of the popular will. They endeavored to establish and make perpetual the reign of law. They crystallized into the Constitution the great principles of free government, and they made it impossible to hastily change that organic law. They declared in express terms the supremacy of the Constitution and the laws made in pursuance thereof; and they created a Supreme Court whose judgments should give effect to that declaration. They united the States in a nation, with full powers of government for all national purposes, but they retained the sovereignty and independence of the States for all purposes of local self-government, and they reserved to the individual citizen as much freedom as is consistent with the enforcement of law and the maintenance of order. While they granted to the United States the power of regulating commerce, they limited the exercise of that power to foreign and interstate commerce.

It is to the States, and not to the United States, that we ought to look for the legislative and administrative regulation of the industrial organizations of the present and the future. The power of the State is ample. A State may create corporations, with or without conditions, and it may authorize a corporation to do any business which an individual may lawfully do. A State may forbid a foreign corporation to do business within its territory; it may permit that business on conditions; and it may, with or without reason, revoke a permission theretofore granted.[2] It may, therefore,

[1] Mrs. Green, *Town Life in the 15th Century*.

[2] W. P. O. Co. *v.* Texas, 177 U. S., 28.

enforce with regard to foreign corporations all, and more than all, the restrictions which it enforces with regard to corporations of its own creation. On the other hand, the United States, save as the domestic government of the District of Columbia and the Territories, cannot even grant a charter of incorporation, except as a means incidental to the exercise by the United States of a power of government,[1] and it can, but only under the power of regulating foreign and interstate commerce, control the operations of a corporation chartered by a State. It does not avail to say that the legislation of a State can have no extra-territorial force, and that in order to have a rule of uniform application throughout the country there must be Congressional legislation, for the conclusive reply is that every State, under the Constitution, is entitled as of right to determine for itself by what agencies and under what conditions commodities shall be manufactured or sold within its territory,[2] subject only to the paramount right of the United States to levy duties and taxes, and to regulate transportation. Nor is it to the interest of the people that a Constitutional amendment should be adopted vesting in the United States the proposed power of regulation. The fatal facility of compromise as shown in the history of the slavery question and the silver issue, and exhibited in every tariff act, and the lack of appreciation of the demands of legitimate business as evidenced by the failure of Congress to do away with the antiquated sub-treasury system and to authorize an elastic currency, demonstrate the unwisdom of vesting in Congress a power which, if exercised, may injuriously affect the business interests of the country.

So far as concerns Congressional legislation under the Constitution as it now is, it would seem that the Supreme Court has put the question at rest, for it has decided[3] that "the relief of the citizens of each State from the burden of monopoly and the evils resulting from the restraint of trade among such citizens were left with the States to deal with;" and that an organization to manufacture and sell is a subject matter of State regulation, for the reason that, while it may bring the operations of commerce into play, it affects

[1] McCulloch *v.* Maryland, 4 Wheat., 316.

[2] U. S. *v.* De Witt, 9 Wall., 41; McGuire *v.* The Commonwealth, 3 *id.*, 387; Patterson *v.* Kentucky, 97 U. S., 501.

[3] U. S. *v.* E. C. Knight Company, 156 U. S., 1, 11.

commerce only incidentally and indirectly. That judgment is unreversed and unshaken, and it is to-day the law of the land.

In the past, the country has had to overcome, under conditions of inadequate transportation facilities, the disintegrating tendencies of the expansion of territory and the growth of population, but as the results of the triumph of the nation in the suppression of the Rebellion, and the development of means of transportation and communication, our perils are now those of governmental consolidation and not those of dissolution. The silver legislation, threatening a degradation of the standard of value; the income taxing law of 1894, unnecessarily vexatious and inquisitorial in its provisions and, by reason of its exemption of incomes less than $4,000 in amount, unjust and unequal in its intended operation; and the laws imposing taxes upon inheritances, increasing progressively in proportion to the amount of the distributive share and teaching the many to expect that the necessary expenditures of government will be borne by taxation to be levied on the few, are illustrations of the perils which may threaten the prosperity of the country. Any legislation which conflicts with the American doctrine that all men are equal before the law, and that equality of rights implies equality of obligations, and that subjects rights of property and freedom of contract to administrative control, is dangerous in a republic governed by universal suffrage.

Every State should encourage the organization under proper conditions of manufacturing and trading corporations, and it should permit them to do any business that an individual may lawfully do. While a State should not undertake to guarantee to the public "in all particulars of responsibility and management" the corporations organized under its authority, it should by conditions annexed to the grant of the charter protect intending and actual shareholders and creditors of the corporation, so far as can be done. It should prohibit and punish fraud in organization or administration. It should afford access to public records showing how the capital has been or is to be paid, and if paid in property, so describing and identifying that property that its value can be tested. It should require the publication at stated periods of balance sheets stating the liabilities under the headings of "shares," "bonds," and "other indebtedness," and the assets under the headings of "real estate and machinery at cost" less stated amounts charged off for depreciation, "cash," "debts collect-

ible," and other "assets," and it should compel the publication at stated periods of an income account, setting forth the total amounts of gross earnings, of operating expenses, interest charges, dividends, and undivided profits. It should also protect minority shareholders by defining the powers of officers and directors, and by requiring due notification of shareholders' meetings.[1] The duties imposed upon the corporations and their officers and the requirements as to reports should be fixed by law, and should not be subjected to the discretion of public officers. If so subjected, there will be a possibility of favoritism on the one hand, or of political intimidation on the other.

The officers and directors of a corporation are trustees for its creditors and shareholders. It is the duty of such trustees, and the interest of their *cestui que trusts*, that there should be, on the part of the trustees, absolute good faith, and as much frankness as is consistent with the protection of the rights of shareholders. No other policy will commend the securities of a corporation to the favorable consideration of investors. Nevertheless, it is certain that no amount of legally enforced publicity will avail to prevent unwise investments and consequent loss. Those who may properly encounter the risks of investment in industrial securities will not do so before they shall have obtained for themselves information as to honesty of organization and adequacy of earning capacity. Those in whom the haste to become rich, and the disinclination to wait for the slow but sure results of industry and frugality have caused a fever of speculation, will take the chances and buy for a rise in the market without regard to the condition of the corporation, real or reported.

Neither the government, nor the public, nor even the purchasers of Trust products provide the capital of the Trusts, but that capital is contributed by their bondholders and shareholders. In so doing, they are not making investments which are of certain return, either in principal or income. As they take the risk of loss, they are entitled to security in their business, to protection in the use of their properties, and to a return proportioned to the risk they have taken and exceeding the current market rate of interest upon securities of a higher grade.

[1] 1903, Report of the Massachusetts Committee on Corporation Laws, by H. M. Knowlton, C. G. Washburn, and Frederic J. Stimson.

While the corporation is a legal entity, distinct from the bondholders and shareholders who contribute its capital,[1] nevertheless the fact remains that the bondholders and shareholders are the persons, or the successors of the persons, whose contributions in money or in property, real or personal, constitute the capital of the corporation, and it is they, or their successors in title, who are benefited by the prosperity of the corporation or injured by its adversity. In the days of the "greenback" agitation, the "bloated bondholder" was the object of fierce denunciation, but when the facts were investigated it was found that the "bloated bondholders" were the saving funds, with whom were deposited the accumulated earnings of labor, the insurance companies, to whom every provident man looked for the future protection of his dependent wife and children from want in case of his death, and the banks, with whom all business men, great and small, deposited the money which they needed for daily personal and business use. Again, when the banks were assailed as heartless money lenders and oppressors, it was seen that the profits of banking accrued to the men, women, and children, who were the shareholders. Again, when Mr. Bryan, in 1896 and in 1900, denounced the holders of "fixed investments" and "the idle owners of idle capital," intelligent people knew that those whose interests he threatened with destruction were the depositors in saving funds, the shareholders in banks, and the holders of policies of life insurance. It will likewise be found to-day that those whose interests will be injured by unwise legislative restraints upon trade and industry will be the workingmen to whom the Trusts offer employment, and the hundreds of thousands of individuals who are, directly or indirectly, the owners of the securities of the Trusts. The leaders of public opinion will do well to remember that, as Mr. Lecky has said,[2] it is an inexorable condition that all "legislation which seriously diminishes profits, increases risks or even unduly multiplies humiliating restrictions, will drive capital away and ultimately contract the field of employment."

[1] Regina *v.* Arnoud, 9 Q. B. 806, 58 E. C. L.; Van Allen *v.* The Assessors, 3 Wall., 573.

[2] *Democracy and Liberty*, Vol. II, page 463.